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TO AMEMBASSY COLOMBO

C O N F I D E N T I A L STATE 061265

AIDAC

E. O. 11652: GDS

SUBJECT: MINFIN PERERA DISCUSSIONS WITH IBRD/ IMF ON REFORM
PACKAGE

REFERENCE: STATE 059450

1. THIS MESSAGE SUPPLEMENTS SEPTTEL ON HANNAH- PERERA CON-
VERSATIONS. FOLLOWING INFORMATION OBTAINED CONFIDENTIAL
BASIS FROM IBRD STAFF MEMBER WHO REQUESTS IT BE CLOSELY
HELD AND OUR KNOWLEDGE OF ITS DETAILS NOT BE REVEALED TO
CEYLONese OR OTHER PARTIES.

2. PRIOR PERERA DEPARTURE FROM COLOMBO, GSL MINPLAN AND
MINFIN HAD CONDUCTED ASSESSMENT OF OUTCOME AID GROUP MEET-
ING PLEDGES AND OTHER RESOURCE AVAILABILITIES AND REACHED
CONCLUSION ASSETS IN SIGHT INSUFFICIENT MAINTAIN FINANCIAL
STABILITY AND CARRY OUT IMPORT PROGRAM FOR 1973. OBVIOUS
ALTERNATIVES WERE (A) CRITICAL REDUCTION INVESTMENT AND
RAW MATERIALS IMPORTS TO UNACCEPTABLE LEVELS OR (B) INITIA-
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TION FURTHER REFORMS OF SUFFICIENT WEIGHT TO MEET IMF/ IBRD AND AID GROUP URGINGS. ACCORDINGLY, STUDY PAPER PREPARED ASSESSING THESE ALTERNATIVES AND DELINEATING VARIOUS OPTIONS FOR REFORM PACKAGE AIMED AT MEETING IMF/ IBRD REQUIREMENTS. PAPER FORWARDED TO PM AND PERERA AUTHORIZED DISCUSS VARIOUS OPTIONS FOR REFORM PACKAGE WITH IMF/ IBRD.

3. IN COURSE OF DISCUSSIONS BANK AND FUND, PERERA REPORTEDLY REACHED DECISION ON CONTENT OF PACKAGE WHICH WE UNDERSTAND HE WILL RECOMMEND TO FULL CABINET ON APRIL 12. FOLLOWING ARE THE THREE MAJOR ELEMENTS:

A. 18 PERCENT DEVALUATION OF CEYLONESE RUPEE TO BE ACCOMPLISHED BY FIXING CEYLONESE RUPEE AT PAR WITH INDIAN RUPEE, AND RETAINING FEEC RATE AT 65 PERCENT;

B. FURTHER EFFECTIVE PRICE INCREASES ON RICE, SUGAR AND FLOUR TO BE CARRIED OUT AS FOLLOWS:

(1) REDUCE SUGAR RATION TO ONE POUND AND INCREASE NON-RATION PRICE TO 2.60 RS PER POUND;

(2) PUT RICE PRICE BACK TO RS 1.60 PER MEASURE;

(3) PUT FLOUR ON RATION AT ONE- HALF POUND AT 35 CEYLONESE CENTS AND SELL NON- RATION FLOUR AT 78 CEYLONESE CENTS PER POUND;

C. FIVE PERCENT WAGE INCREASE ACROSS- THE- BOARD.

4. BANK SOURCE ASSESSES THESE MEASURES AS REALLY DRASTIC AND CONSIDERS THEM TO BE, IF ADOPTED, A MAJOR STEP IN THE DIRECTION OF NEEDED REFORM. POTENTIAL EFFECTS OF THESE MEASURES WOULD BE, AMONG OTHERS:

A. 22 PERCENT AVERAGE PRICE INCREASE FOR IMPORTS;

B. ESSENTIALLY OFFSET IN DOMESTIC BUDGET TERMS FOR INCREASED FOREIGN EXCHANGE COSTS RESULTING FROM WORLD PRICE INCREASES OVER PAST YEAR FOR GSL FOOD IMPORTS THEREBY RESTORING BUDGET POSITION TO THAT OF LAST NOVEMBER.

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C. REDUCE RICE SUBSIDY COSTS FROM RS 600 MILLION TO RS 450 MILLION (WITHOUT THESE MEASURES RICE SUBSIDY COST WILL RISE FROM RS 600 MILLION TO RS 900 MILLION IN 1973);

D. INCREASED RUPEE RETURNS TO ESTATE AGRICULTURE WHICH COULD STIMULATE RESUMPTION OF INVESTMENT IN THIS SECTOR.

5. SOURCE ADVISES THESE PROPOSALS DISCUSSED IN DETAIL WITH IMF AND FUND REACTION REPORTEDLY FAVORABLE. ATTITUDE TOWARD NEW STANDBY ARRANGEMENT LIKELY BE POSITIVE IF GSL ADOPTS PACKAGE ESSENTIALLY AS PRESENTED ABOVE. FUND TEAM DEPARTED WASHINGTON THIS PAST WEEKEND AND FURTHER DISCUSSIONS OF REFORMS WILL TAKE PLACE DURING COLOMBO VISIT.

6. DE ALWIS HAD RUMORED TO US POSSIBILITY CARGILL MAY STOPOVER COLOMBO DURING CURRENT VISIT INDIA AND BANGLADESH TO HAVE SOME DISCUSSION WITH PM AND PERERA ON NEW PROPOSALS. BANK SOURCE INDICATES SUCH STOPOVER BY CARGILL BEING CONSIDERED BUT BELIEVES DECISION WILL PROBABLY BE NEGATIVE.

7. COMMENT. PACKAGE OUTLINED ABOVE COULD BE IMPORTANT STEP IN STABILIZING CURRENT SITUATION AND BUYING MORE TIME FOR CONSIDERATION OTHER CONSTRUCTIVE STEPS IN AREAS OF SAVINGS AND INVESTMENT, GENERAL PRICE RELATIONSHIPS AND EMPLOYMENT. MAJOR GAIN WOULD BE TO RESTORE DOMESTIC BUDGET SITUATION TO THAT PROJECTED LAST NOVEMBER WHEN RS 56 MILLION SURPLUS PREDICTED. SOME REDUCTION IN CONSUMPTION OF IMPORTED RICE, FLOUR, SUGAR CAN BE EXPECTED, BUT PROBABLY NOT LARGE ENOUGH TO HAVE MUCH SIGNIFICANT EFFECT ON FOREIGN EXCHANGE IMPORT BILL. PACKAGE CONTAINS NO MEASURES AIMED AT CREATING MORE ACCEPTABLE LEVEL OF PUBLIC SAVINGS AND INVESTMENT, WHICH RECEIVED STRESS AT AID GROUP MEETING. SOURCE NOTED GSL STUDYING SEVERAL TENTATIVE PROPOSALS BEARING ON REDUCING LOSSES AND INCREASING EFFICIENCY PUBLIC CORPORATIONS BUT EXPECTS NO DECISIONS UNTIL LATER IN YEAR. REAL QUESTION IS WHETHER PACKAGE WHICH FINALLY EMERGES FROM CABINET AND PARLIAMENT REVIEW WILL BE JUDGED BY BANK AND FUND TO BE RESPONSIVE TO CONCERNS EXPRESSED BY THESE INSTITUTIONS AND AID GROUP MEMBERS. RUSH

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